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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992; Fifth Notice of Proposed Rulemaking	))))))))	MM Docket 92-266

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COMMENTS OF VIACOM INTERNATIONAL INC.

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To: The Commission

COMMENTS OF VIACOM INTERNATIONAL INC.

Viacom International Inc. ("Viacom"), by its attorneys, hereby submits these comments in response to the Commission's Fifth Notice of Proposed Rulemaking in the above-captioned proceeding.[1] The Commission has invited comment on, among other things, the subject of how FCC rate regulations could be fine-tuned to avoid disincentives for programming investment generally. Viacom therefore submits these comments to address significant shortcomings in the rate regulations with regard to the continued growth of programming, deficiencies that warrant careful consideration and effective, program-service neutral remedies.

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[1] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, Fourth Report and Order and Second Order on Reconsideration and Fifth Notice of Proposed Rulemaking in MM Docket No. 92-266, FCC 94-38 (rel. March 30, 1994) ("Second Order on Reconsideration," "Fourth Report and Order," or "Notice").

I. INTRODUCTION AND SUMMARY

Through its varied program interests,[2] Viacom has experience with the distinct economics of operating program services that are well-established and enjoy wide distribution (e.g., Nickelodeon/Nick at Nite, MTV: Music Television), and those that are less widely distributed and are actively pursuing wider carriage (e.g., VH-1, Comedy Central), as well as with existing start-up channels which require that channel capacity be found or created (e.g., MTV

[2] Viacom's MTV Networks division ("MTVN") owns the advertiser-supported program services MTV: Music Television, VH1/Video Hits One, and Nickelodeon (comprised of the Nickelodeon and Nick at Nite programming blocks). Viacom's wholly-owned subsidiary Showtime Networks Inc. ("SNI") owns the premium program services Showtime, The Movie Channel, and FLIX, and Viacom's wholly-owned subsidiary MTV Latino Inc. owns the advertiser-supported program service MTV Latino, which is distributed domestically and to Latin American territories. In addition, Viacom (either directly through its subsidiary Paramount Communications Inc., or through wholly-owned subsidiaries of affiliated entities) holds partnership interests in the advertiser-supported program services Comedy Central, USA Network, Sci-Fi Channel, and All News Channel, as well as in the regional sports services Prime Sports Northwest and the MSG Network. Viacom also owns Showtime Satellite Networks Inc., which licenses the SNI, MTVN and a variety of third-party program services to owners of home television receive-only earth stations nationwide. Further, Viacom also owns cable systems serving approximately 1.1 million subscribers and is engaged in: television and radio broadcasting; the production and licensing of syndicated and network television programming and interactive media; the production, distribution and exhibition of theatrical motion pictures; the ownership and operation of professional sports franchises; the ownership and operation of amusement parks and arenas for live entertainment; the publication and distribution of education, business and trade books; and the licensing and merchandising of trademarks.

Latino and All News Channel). This experience has convinced Viacom that the FCC's regulatory policy for increasing incentives for investment in programming must be neutral as to both content and type of program service and should not determine the success of a program service; success in the marketplace should depend upon consumer acceptance alone. Further, Viacom Cable has unused capacity as a result of recent investment in cable system rebuilds and needs certainty regarding the treatment and incentives for adding new services before it can make a reasoned business decision.

Accordingly, Viacom believes that, whatever measures the Commission deems appropriate to enhance incentives for adding new channels, the going-forward rules must not treat already-carried program services so inequitably that it is more beneficial economically for a cable operator to add new program services and, in turn, devote resources to such programming than it is to continue to devote resources to established, already-carried program services. To that end, Viacom recommends an enhanced mark-up on incremental increases in programming expenses equal to the average percentage margin embedded in a system's benchmark rates.

Viacom further recommends that the Commission provide operators with guidelines that facilitate the safe "reverse migration" to a regulated tier of services launched on an a la carte basis. Viacom also urges the FCC to simplify the process for operators to pass through programming expenses and other external costs (such as PEG costs, taxes, and the costs of satisfying franchise requirements) by limiting local franchising authorities' excessive ability to delay, if not deny, the recovery of such expenses. Moreover, where complaints concerning the cable programming services tier are filed in response to an external cost pass-through, the Commission should limit the scope of the ensuing rate review -- at least for operators who have restructured their rates in response to the Commission's rules -- to the amount of any rate increase, rather than open up the entire rate structure to review.

II. THE COMMISSION SHOULD PROVIDE FAR GREATER, BUT STILL CONTENT AND PROGRAM SERVICE-NEUTRAL INCENTIVES FOR OPERATOR INVESTMENT IN PROGRAMMING

While the pervasive regulation of cable operators unavoidably affects program providers in some measure, the Commission should ensure that its rules -- as enhanced to further restore programming investment incentives -- do not also inadvertently tilt the programming marketplace in favor of one programmer over another. As the legislative history of the 1992 Cable Act recounts, "since cable rates were deregulated in 1986 there has been an increase in the quality and diversity of cable programming." H.R. Rep. No. 628, 102d Cong., 2d Sess. 86 (1992). The FCC's rules should thus take great care not to cripple the strengths of this pre-existing programming marketplace.

The Commission's Fourth Report and Order established a going-forward methodology for adjusting regulated rates when channels are added to regulated tiers. Operators, under this scheme, are permitted a modest "network cost adjustment" that avowedly covers the non-programming costs of adding a channel, as well as a 7.5% mark-up on new programming expenses. Operating together, these measures are designed to "help promote the growth and diversity of cable programming services." Fourth Report and Order at ¶ 246. A number of programming interests, however, have petitioned the Commission to strengthen the incentives for programming investment, arguing that the current scheme is simply inadequate to achieve the FCC's asserted goal.[3]

Viacom, while strongly concurring with the numerous parties asking the Commission to adopt enhanced incentives

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[3] See, e.g., Petition for Reconsideration of Viacom International Inc. in MM Docket No. 92-266 (May 16, 1994) at 1-7; Comments of the Times Mirror Company in MM Docket No. 92-266 (May 16, 1994) at 1-7; Petition for Reconsideration of Eternal Word Television in MM Docket No. 92-266 (May 16, 1994) at 2-6; Petition for Clarification or Partial Reconsideration of the Office of the Commissioner of Baseball in MM Docket No. 92-266 (May 16, 1994) at 1-3; Petition for Expedited Reconsideration of Public Interest Petitioners in MM Docket No. 92-266 (May 16, 1994) at 1-16; Petition of United Video for Reconsideration in MM Docket No. 92-266 (May 16, 1994) at 8; Comments of Programming Providers in MM Docket No. 92-266 (May 16, 1994) at 1-13; Comments of C-SPAN and C-SPAN 2 in MM Docket No 92-266 (June 7, 1994) at 2-10.

for programming investment, urges the Commission to do so in a neutral manner that neither favors nor disfavors one class of program services over another. If FCC regulation is not to create market distortions but rather replicate market incentives for optimal programming investment, the necessary modifications in the Commission's going-forward rules must apply the principle of regulatory neutrality to the fullest extent. As Viacom has previously commented to the Commission, the public interest in programming investment encompasses not only the addition of new program services, but also the continued investment in high-quality program services an operator already carries.[4] The incentives ultimately adopted to restore investment in programming must therefore neither privilege new programming services over existing services, nor favor no-fee or low-fee program services over higher fee programming.

Accordingly, whatever means the FCC pursues to enhance operators' incentives for adding channels to regulated tiers of cable service, the FCC should do so in an evenhanded manner that does not prejudice already-carried program services. First, the Commission should clarify that, consistent with its rules,[5] any enhanced network cost-type

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[4] See Comments of Viacom International Inc. in MM Docket No. 92-266 at pp. 4-5 (September 30, 1993).

[5] See 47 C.F.R. § 76.922(e).

adjustment incentives for the addition of programming apply only to a net increase in the number of channels on a regulated tier, and not to newly substituted programming carried on channels already in use on a tier. Operators should not be economically encouraged to substitute programming carried on existing channels with new programming on such channels in order to obtain the benefit of any enhanced network cost-type adjustments. Such a scenario would disserve the public interest by not only creating needless subscriber confusion, but also placing at risk the ability of existing advertiser-supported networks to continue to provide consumers with high-quality programming at a relatively modest price.[6]

Second, the Commission should clarify that the enhanced incentives apply to all channels added on a regulated tier. For example, these incentives should clearly apply to a program service previously carried on a half-time or lesser basis, sharing a channel with another service, if and when such program service is carried on a channel on a full-time basis, thereby increasing the number of channels on the

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[6] The viability of an advertiser-supported program service, as the Commission is well aware, hinges on a programmer's ability to distribute the service to the maximum possible number of subscribers. Advertising revenues earned by the programmer increase as a function of total viewership. Therefore, the large advertising revenue base available to a programmer carried on a regulated, widely distributed tier enables the programmer to deliver high quality, original programming to cable subscribers at a reasonable cost.

regulated tier. Such a ruling will serve the public interest by encouraging the nurturing and eventual full-time carriage of innovative and fledgling cable networks to the benefit of the viewing public.

Moreover, in order to maintain a policy of regulatory neutrality between newly-carried and already-carried program services, any enhanced incentives to add never before carried services on added channels must be implemented together with rules that provide for a meaningful increase in the percentage of the mark-up allowed on programming expenses arising from existing program services (i.e., increased license fees). In this regard, Viacom recommends that the FCC adopt a mark-up on license fee increases that is based on the average percentage margin embedded in each system's regulated tier under its applicable benchmark rates. The mark-up would thus be equal to the percentage of a tier price above an operator's direct programming costs for the tier. Like the proposals suggested by Continental Cablevision and A&E/ESPN for the addition of new channels,[7] this approach relies on the margins embodied in the Commission's benchmark formula.

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[7] See Comments of A&E and ESPN in Support of Petitions for Reconsideration in MM Docket No. 92-266 (filed June 16, 1994) at 11-12; Response of Continental Cablevision, Inc. to Petitions for Reconsideration in MM Docket No. 92-266 (filed June 16, 1994) at 10-12.

Given that the Commission has determined that the rates produced under the benchmarks are reasonable, it follows that the percentage of the retail price above an operator's cost also must be reasonable. To illustrate with the same hypothetical figures used by Continental, if an operator's retail tier price is $10.00 and the operator's cost for the underlying programming is $4.00, the resulting mark-up percentage under this approach would be ($10.00 - $4.00)/$10.00, or 60%. Such an enhanced mark-up on incremental programming expenses would further the public interest in the growth and improvement of existing cable programming, while also protecting subscriber interests by ensuring that an operator's mark-up is commensurate with the operator's presumptively reasonable benchmark margins.

Further, if the Commission determines that a cap is warranted on the compensation allowed operators not only for the addition of new channels but also for license fee increases, several issues must be clarified. First, in no event should the cap apply to the underlying license fee increases, which the Commission has already soundly determined warrant pass-through. Such a restriction clearly would burden the continued growth of programming, contrary to the Commission's objective. Second, any caps on the two discrete categories of programming investment should be wholly separate and not combined into one aggregate cap. A separate cap is appropriate and essential given the percentage nature and predictably more limited magnitude of the mark-up on license fee increases.

III. THE COMMISSION SHOULD MODIFY CERTAIN PROCEDURAL AND RELATED RULES THAT UNINTENTIONALLY UNDERMINE THE CONTINUED GROWTH OF THE PROGRAMMING MARKETPLACE

Viacom views as essential to the continued health of the programming marketplace modification of certain procedural and related rate regulations directed not at programmers, but at operators. Satisfactory resolution of these issues -- regulating "reverse migration," basic tier external cost recovery and the scope of cable programming tier complaints -- should, nonetheless, be counted among the vital programming issues that must be addressed in this proceeding.

A. To Better Effectuate the Programming Goals of the 1992 Cable Act, the FCC Should Allow a Clear Path For "Reverse Migration" of Services Initially Launched on an A La Carte Basis

To help ensure programmers the opportunity to obtain and maintain the widest possible distribution to the viewing public, Viacom urges the FCC to adopt interpretive guidelines under which cable operators who have initially launched a program service on an a la carte basis may safely move the network from a la carte carriage to a regulated tier. Without such guidance, a program service could be forced to endure prolonged a la carte carriage even where an operator concurs that such carriage has proven detrimental to the success of the service.

To facilitate such "reverse migration" in this specific context, the Commission should clarify that operators who move such a program service to a regulated tier would not run afoul of the Commission's negative option billing rule. The FCC also should clarify that new channel rate adjustments for added channels would reasonably apply to such reverse migrated services. By adopting these guidelines, the FCC will better serve the public interest by encouraging operators to help ensure a more diverse range of program offerings on regulated tiers.

B. The Commission Should Alter its External Cost Recovery Rules to Both Eliminate the Overbroad Requirement of Local Approval for Pass-Throughs and Minimize Regulatory Lag

The Commission's new rules governing the pass-through of external costs contain built-in regulatory lags and needlessly require operators to absorb increases in programming and other external costs -- such as taxes, PEG costs and the costs of satisfying franchise requirements -- pending regulatory approval of the proposed rate, which may be inordinately delayed or even withheld. Viacom urges the FCC to modify the rules governing recovery of external costs to eliminate the overbroad local approval requirement and reduce this costly delay.[8]

While reasonable notification requirements at the local or federal level are certainly appropriate, the Commission's additional requirement that the local regulator must approve the pass-through for increases in basic tier rates shrouds investment decisions in uncertainty by subjecting operators to potentially prolonged periods of uncompensated outlays. This rule is therefore very damaging to those programmers who are carried on the basic tier or are seeking carriage on that tier. This is a large barrier for program services seeking support from operators for carriage of new and improved program services.

Viacom urges the Commission to reconsider the Bureau's recent conclusion that local approval -- as opposed to notice -- is required by the 1992 Cable Act for proposed rate increases resulting from increased external costs. The Commission, in originally establishing the external cost mechanism, appropriately envisioned these costs as being "automatically passed-through" to subscribers "without prior

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[8] While the focus of the instant proceeding is on programming issues, Viacom believes that the modifications proposed herein should apply to the recovery of <u>all</u> external costs, not programming costs alone.

regulatory review."[9] As the FCC reasoned in the Rate Order, this approach is logical since external costs are caused by factors outside of operators' control.[10] Consistent with this stated purpose and operation of a pass-through mechanism, the role of the local authority in examining a proposed pass-through should be only to ensure the bona fides of the costs. This duty could be executed easily within the 30-day statutory notice period. Indeed, 30-day notice has been deemed sufficient for FCC review of a proposed rate while a tier complaint is pending. See 47 C.F.R. § 76.958. The FCC should thus eliminate the requirement that local regulators must affirmatively approve the pass-through.

Under the current rules, operators cannot charge rates that recover their increased external costs until, at an absolute minimum, 30 days after the close of a quarter. Further, this regulatory loss can stretch beyond 120 days if a local franchising authority exercises its discretion to extend the deadline for approval of the proposed rate for an additional 90 days pursuant to Section 76.933 of the Commission's rules. Given the inevitable "tug-of-war" between certain localities and operators over basic tier rates, this discretion may be abused, notwithstanding the

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[9] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, 8 FCC Rcd 5631, 5786 (1993) ("Rate Order").

[10] Id.

Commission's admonition that "local authorities receiving such a rate increase request should act on it promptly, and should endeavor to approve it, where at all possible, within 30 days."[11]

In light of these serious shortcomings in the external cost recovery procedure, the Commission should adopt measures that reduce or eliminate the lag and risk of loss intrinsic in the current process. At a minimum, if the Commission fails to rescind the overbroad local approval requirement, it should allow a proposed rate to automatically become effective after 30 days from the date of submission, subject to refund liability in the event that the franchising authority later disapproves the proposed rate. This procedure would operate in a fashion similar to that used for approval of initial permitted rates. In this way, the local authority would retain its ability to extend the deadline for approval, yet the extension would not inappropriately prolong

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[11] Letter from Alexandra M. Wilson, Acting Chief, Cable Services Bureau, FCC to Mr. Robert Corn-Revere and Ms. Jacqueline Cleary, Hogan & Hartson (dated April 19, 1994) at p.3, ¶ 9. A franchising authority need only issue an extension order to delay approval of new programming investment and other external costs for three months. Local regulators thus might find it politically expedient to disapprove or delay approval of a proposed rate, as they lack any incentive whatsoever to expeditiously approve a pass-through. If the Commission's rules are not modified to address this problem, legitimate cost pass-throughs will be unrecoverable and lost forever, as neither the 1992 Cable Act nor the Commission's rules provide avenues for cable operators to recover from customers amounts that lawfully should have been charged.

the period in which the operator is precluded from recovering its investment through charges ultimately found to be proper.[12] If the rate is ultimately disapproved, the operator would be liable for a refund.

In addition, to reduce the period of uncompensated investment in new or enhanced programming, operators should be permitted to file in advance for known programming cost increases. For example, an operator that is contractually obligated to begin carriage of a new programming service on August 1, 1994 will be forced to absorb the costs of this programming until at least 30 days after the end of September 1994. An advance filing rule would enable the operator to file for the increase in July (with the filing for the second quarter) so that programming investment can be recouped as of the start date of carriage. To ensure that an operator actually incurs costs for which it has filed in advance, the Commission could either require that a contractual obligation exist for carriage of programming or require prior completion

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[12] Specifically, and in conformance with Section 76.933 of the Commission's rules, the franchising authority, in order to avail itself of the extension, should be required to issue an extension order within 30 days of the rate submission. Unlike current Section 76.933, however, this extension order should not stop the rate from going into effect until an additional 90 days. Rather, the FCC should permit the rate to go into effect at the conclusion of the 30-day period and the local authority would then have 90 days to determine its propriety.

of subscriber notification of the addition of a new service or rate increase based on higher programming costs.[13]

In addition to any modifications of the rules governing the local approval of pass-through costs, it is critical to the predictability of the cable programming business environment that the Commission adopt an expedited procedure to review disparate and potentially conflicting local external cost pass-through determinations. Given the potential adverse impact such decisions might have on a cable operator's capacity to absorb programming fees -- and the resulting adverse effect that this would have on investment by programmers in new and enhanced programming -- a final determination on the local decision must be made quickly by the FCC, which follows its own precedent on a consistent and predictable basis. Likewise, to ensure that operators are able to recoup their investments through rates later deemed reasonable by the FCC, operators should be entitled to an

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[13] Consistent with its recent clarification of accrued programming expenses, see Questions and Answers on Cable Television Rate Regulation (rel. June 14, 1994) at p. 2, the FCC also should allow operators to aggregate all amounts not recovered in the timing gap between addition of programming (or increased programming costs) and final approval of the rate increase, and then upon approval begin to pass through these amounts spread over a reasonable period of time. Alternatively, the Commission could allow operators to accrue and carry the amounts on their books until the program cost (or increase) has terminated. The operator would then be allowed to maintain the charge in the absence of the programming expense for a period of time commensurate with the original timing gap.

automatic stay of an order denying a proposed rate pending Commission review. The proposed rate would thus take effect, subject to potential refund liability, while the review process is completed. In sum, Viacom strongly recommends that the Commission rework the external cost recovery procedures as outlined above to avoid both significant disincentives to investment in programming and unnecessary delay in the recovery of other permitted external costs.

C. The Rule Allowing Pass-Through Costs to Trigger a Review of an Operator's Entire and Otherwise Final Rate Structure Adversely Affects Investment in Programming and Must Be Modified

As currently interpreted, the Commission's rules governing the cable programming services tier complaint process unintentionally create a significant disincentive to increased investment in new or already carried program services by creating regulatory impediments to, and dangers that would result from, an operator's willingness to pay increased programming costs charged by the programmer. Viacom respectfully submits that in order to achieve the Commission's asserted goal of "growth of programming," Notice at ¶ 256, it is imperative that the scope of review triggered by a cable programming services complaint in response to a rate increase not jeopardize an operator's entire rate structure. Rather, review in such cases should be limited to the amount of the increase, and should not apply to the prior underlying rate. Consumers will remain well protected if this ruling is made applicable to all operators who have restructured their rates in response to the Commission's regulations (as well as operators whose rates were in accordance with the FCC's rules without restructuring). The Commission might determine, however, that operators who failed to reduce their rates voluntarily should not be entitled to the benefit of this provision.

Under the current FCC rules, a cable operator whose rolled-back rates have not warranted a complaint -- and even operators who have responded to prior complaints and completed the rate review process -- will be highly disinclined to incur the costs of adding a new program service or paying additional license fees because the resulting pass-through to subscribers could subject the operator's entire reduced rate structure, rather than just the amount of the increase, to review. Even though the February 28, 1994 deadline for complaints has long since passed,[14] the Commission has determined that a complaint filed in response to a rate increase subjects the operator's

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[14] Section 76.953(a) of the Commission's rules provides that subscriber complaints directed at rates for cable programming services as of the effective date of regulation (September 1, 1993) must be filed within six months -- by February 28, 1994. 47 C.F.R. § 76.953(a). After February 28, 1994, complaints may be filed only if an operator changes its rates (complaints must be filed within 45 days of receipt of the bill indicating the increase). Id. at § 76.953(b).

entire existing and previously unchallenged rate structure to review. Rate Order, 8 FCC Rcd at 5866; see also New Release, Mim. No. 41723 (rel. Feb. 9, 1994).

Thus, an operator's subsequent addition of a new channel to the cable programming services tier or an increase in a cable programming service's license fee may occasion a comprehensive rate proceeding for reduced rates assumed to be reasonable and final. The specter of such a proceeding will without question discourage even those operators who voluntarily restructured their rates from incurring these additional programming costs. This possibility is especially troubling in the context of increases in network license fees. An operator whose reduced rates have not been challenged will weigh the negligible effect of a several penny increase in program fees against the considerable uncertainty of opening an established rate structure to review. The outcome is virtually predetermined: operators will frequently decide against carriage of new program services and will refuse to pay network license fee increases. As a result, programmers, both new and existing, will be substantially impaired in their ability to receive fair prices -- and, consequently, fair and acceptable returns on their costs and investments -- as operators understandably opt for certainty and reduced risk by not jeopardizing their entire rate structure.

Viacom respectfully submits that the Commission can ameliorate the effect of this rule by clarifying that -- at least insofar as an operator who has restructured rates in response to FCC rulings is concerned[15] -- a complaint filed in response to a rate increase governed by Form 1210 subjects only the amount of the increase to review. Such a ruling would further the FCC goal to promote programming growth by removing a significant impediment to the restoration of operators' marketplace incentives to investment in programming.

[15] This would include operators who, under Section 76.922(b) of the Commission's rules, have sought to reduce their rates to either the "full reduction rate," the "transition rate," or in accordance with the streamlined rate reduction provisions.

IV. CONCLUSION

Viacom respectfully urges the Commission to modify its rules, consistent with the principles and proposals set forth above, so as to minimize the distortions and contraction of the otherwise thriving programming marketplace on which the American viewing public depends.

Respectfully submitted,

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